

# **EXHIBIT I**

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549  
**Form 10-K**

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 000-22023

**Macrovision Corporation**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**77-0156161**  
(I.R.S. Employer  
Identification Number)

**2830 De La Cruz Boulevard**  
**Santa Clara, California 95050**  
(Address of principal executive offices) (Zip Code)

**Registrant's telephone number, including area code:**

**(408) 562-8400**

**Securities registered pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Exchange on Which Registered
Common Stock, \$.001 Par Value	The Nasdaq Global Select Market

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Act. Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated or, a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant was approximately \$1,126,823,719 as of June 30, 2006, based upon the closing price on the Nasdaq National Market reported for such date. This calculation does not reflect a determination that certain persons are affiliates of the Registrant for any other purpose. The number of shares outstanding of the Registrant's Common Stock on February 15, 2007, was 52,161,566 shares.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates information by reference from the definitive proxy statement for the 2007 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days of the fiscal year ended December 31, 2006.

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**MACROVISION CORPORATION**

**FORM 10-K**

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*Discussions of some of the matters contained in this Annual Report on Form 10-K for Macrovision Corporation ("Macrovision," "we" or "us") may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, and as such, may involve risks and uncertainties. Some of these discussions are contained under the captions "Item 1. Business" and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations." We have based these forward-looking statements on our current expectations and projections about future events or future financial performance, which include implementing our business strategy, developing and introducing new technologies, obtaining, maintaining and expanding market acceptance of the technologies we offer, and competition in our markets.*

*In some cases, you can identify these forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "future," "predict," "potential," "intend," or "continue," and similar expressions. These statements are based on the beliefs and assumptions of our management and on information currently available to our management. Our actual results, performance and achievements may differ materially from the results, performance and achievements expressed or implied in such forward-looking statements. For a discussion of some of the factors that might cause such a difference, see "Item 1A.—Risk Factors" and elsewhere in this Form 10-K. We specifically disclaim any obligation to update such forward-looking statements.*

## PART I

### ITEM 1. BUSINESS

Macrovision Corporation, a Delaware corporation founded in 1983, enables businesses reliant on the deployment of software or content to protect, enhance, or distribute their offering among digital distribution channels and destination devices. These digital lifecycle management solutions include anti-piracy and content protection technologies and services, digital rights management products and technologies, embedded licensing technologies, usage monitoring for enterprises, access control and billing, and several other related technologies and services from installation to update to back-office entitlement management. We market the FLEXnet licensing platform and the InstallShield suite of software installation, repackaging, and update solutions. We also operate a game network for digital distribution of downloadable PC games, and market our Rights products, which enable the sale and security of digital goods and services, such as text, audio, video, streaming media, games and applications. Our customers consist of entertainment producers such as motion picture studios and music labels, software publishers, hardware manufacturers, consumer electronic firms, personal computer manufacturers, digital set-top box manufacturers, digital pay-per-view and video-on-demand network operators, publication companies and enterprise information technology organizations.

We own or have rights to various copyrights, trademarks and trade names used in our business. These include, but are not limited to, Macrovision®, ActiveMark®, ActiveReach™, AdminStudio®, C-Dilla®, eMeta®, FLEXbill™, FlexCertified™, FLEXenabled®, Flexible License Manager®, FLEXlm®, FLEXnet®, Flexnet Connect™, GLOBEtrotter®, Hawkeye®, InstallShield®, Install From The Web®, InstallShield Developer®, InstallShield DevStudio®, InstallShield Professional®, It All Starts Here®, M1 Mediabolic®, Mediabolic®, One-Click Install®, PackageExpert™, Package for the Web®, PowerUpdate®, Quick Patch®, RipGuard®, SafeAuthenticate®, SafeDisc®, SOFTSUMMIT®, TryGames™, Trymedia Systems®, Un-Installshield®, and Zero G Software®.

### Industry Background

The design, distribution, protection and consumption of all forms of digital content and software are continuing to experience an unprecedented amount of change. In the case of entertainment content, with the expansion of high-bandwidth internet infrastructure and the industry shift to digital media, PC-based entertainment platforms, digital portable devices, networked devices, Internet downloads and the proliferation of

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peer-to-peer file sharing networks, content and copyright owners are vulnerable to unauthorized use of their content. Inexpensive, easy to use in-home copying devices, such as VCRs, CD and DVD recorders, and PC based hard drive recorders enable consumers to make unauthorized copies of video, audio and software content. Content owners lose billions of dollars every year to casual copying and professional or bootleg piracy and Internet/peer-to-peer ("P2P") piracy. Many of the same challenges confront the software industry. Independent software vendors and systems vendors are similarly concerned about unlicensed or illicit use of their application software, both in the enterprise environment (where license terms may be lost in the midst of corporate IT confusion or ignored) and in the consumer markets (where PC software may be copied and redistributed). As technological advances facilitate digital downloads and digital copying, motion picture studios, music labels, cable television program distributors and software games publishers have become more concerned with protecting their intellectual property.

In addition, in the software industry, publishers need simple, scalable solutions to account for the use of their products and also are seeking ways to flexibly price and package their products in order to reach a larger share of the available market. Furthermore, as software complexity grows, publishers are seeking ways to simplify their customers' software experience. Enterprise customers are particularly focused on reducing their total cost of ownership of software and reducing their support burden. Tools that provide a simple installation, activation and maintenance experience are winning favor with these enterprise customers. The challenge for the software industry, and their end-customers, is to simultaneously optimize accountability, manageability, stability and delivery in a constantly evolving business environment.

## **Macrovision Business and Solutions**

We develop and market a broad array of commerce, protection and management solutions for software, entertainment and information publishing industries across three distinct customer groups: Entertainment and Content Producers and Distributors, Software Publishers, and Enterprise End Users.

### **Entertainment and Content Producers and Distributors**

Macrovision solutions enable the delivery, protection and use of digital goods in the entertainment and content marketplaces. Our solutions provide enhanced consumer experiences, digital distribution, merchandising and advertising, as well as flexible content security, such as authentication and digital rights management ("DRM").

#### ***Video Technology***

*Packaged Media Solutions.* Motion pictures typically generate two-thirds of their revenue from the sales of packaged media, primarily DVDs. Any household that owns a DVD-R, personal video recorder ("PVR"), PC, media center or a VCR is capable of making unauthorized high quality digital and analog copies unless that content is properly copy protected against this variety of threats. As new distribution models evolve, including video portability, simultaneous theatrical and DVD release dates, Internet and other electronic distribution and the developing PC-based home theater experience, solutions that protect the DVD from unauthorized copying are critical to preserving the motion picture studio revenues.

Our business originated in analog video content security, or analog copy protection ("ACP"), which has been used to protect over 4.7 billion videocassettes worldwide since 1985 and over 7.1 billion DVDs worldwide since 1997. Our ACP technologies allow consumers to view programming stored on prerecorded videocassettes and DVDs or transmitted as digital pay-per-view ("PPV") or video-on-demand ("VOD") programs via cable or satellite, but deter unauthorized consumer copying of such programming on both VCRs and recordable DVD devices. Most of the Motion Picture Association of America ("MPAA") studios use our video content security technology to protect some or all movie releases on videocassette or DVD. In addition, nearly every DVD player, VCR, DVD recorder, DVD drive and PC manufactured contains software and/or hardware technology, licensed by Macrovision, to ensure that ACP-secured DVDs and VHS tapes are properly recognized and thus secured.

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In recent years, digital content protection has increased in importance. Consumers can make a perfect digital copy of a DVD in minutes by using inexpensive PC DVD burners coupled with copying software that is widely available in electronics stores and from Internet sites, with many of these software products being available free-of-charge. This class of software technology, known as DeCSS rippers, breaks the CSS encryption code that is used on most movie DVDs, and often circumvents the Macrovision analog content security. Therefore, we believe such software packages violate the U.S. Digital Millennium Copyright Act of 1998 ("DMCA") and infringe our patents. Nevertheless many consumers acquire this type of software and add hacker software available on the Internet, and engage in unauthorized ripping and copying activities. Our RipGuard DVD technology, which is applied to the DVD at the time of manufacture, is designed to prevent unauthorized ripping on PCs without requiring any modification to the PC. We introduced RipGuard DVD in 2005, and to date, over 278 million DVDs that used the comprehensive content security solution of RipGuard DVD and ACP were shipped. In addition, RipGuard DVD is THX Verified to ensure high quality audio and video fidelity and also is certified "Spyware Safe" by PC Tools, a leading member of the Anti-Spyware Coalition.

*PPV and VOD Solutions.* Digital PPV/VOD services enable consumers to purchase and view movies and other programming in their homes through cable or satellite systems, or Internet-based download services. As entertainment content producers consider the idea of simultaneous or more closely staged theatrical, DVD and/or PPV/VOD release of content, studios have realized the importance of content security in digital PPV/VOD networks because high quality VHS and DVD copies can be made from the source analog video signal. Many digital PPV/VOD system operators have implemented our content security capability in their digital set-top boxes at the request of the Hollywood studios.

To protect content in such circumstances, Macrovision introduced our ACP-VOD and ACP-WMDRM solutions, which are derived from the same ACP technology used in our packaged media solution. These products are designed to allow content owners to copy protect their PPV/VOD movies, while at the same time allow consumers to store, move or share content as long as it is done within the parameters of the rules defined by copyright owners. To date, our content security technology has been embedded in over 249 million digital set-top boxes and digital video recorders ("DVR") worldwide.

*Peer-to-Peer File Sharing Solutions.* Millions of online users have reported using file sharing applications to share music, movies or photos on a monthly or more frequent basis. Content owners believe they have been harmed by the free and unauthorized file sharing over these networks to such an extent that they have initiated lawsuits against several of the file sharing networks and even the individual consumers themselves. Our RipGuard DVD content security solution is designed to inhibit unauthorized video and music content from being made available over P2P networks. Our Hawkeye Peer-to-Peer Anti-Piracy service is a global network solution designed to deter the majority of users from obtaining any unauthorized copies of copyrighted content from P2P file sharing networks. Content owners are able to designate which music tracks, music albums, movies, television episodes, games or software applications they want to protect, and our technology is activated as a service to find and protect those specific files on various file sharing networks.

### ***PC Games Technology***

The PC games industry is facing a range of issues as its market adjusts to changing distribution opportunities. They continue to suffer the effects of piracy negatively impacting sales, as the retail distribution market becomes more consolidated with less shelf space available to games. At the same time, for core game publishers games now require much larger budgets for creating and promoting games. Publishing, distributing, merchandising, selling, and marketing video games is more costly now than it has ever been. Increasingly immersive and sophisticated games cost millions to produce, yet the timeframe to develop them has remained the same. To counterbalance these trends, the growth of broadband Internet connections to the home and small office has created a new class of casual game publishers reaching a broader market demographic. Our digital distribution capabilities along with our SafeDisc and ActiveMARK technologies are designed to (i) enable an entirely new revenue channel with online merchandising and digital distribution of games and (ii) protect both CD/DVD-ROM and digital game content from unauthorized copying.



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Our technologies are enabling a significant change in the gaming market—digital distribution. Our games solution provides an integrated technology platform so that publishers, distributors, and community sites can easily adapt to new distribution and business models, quickly protect copyrighted content from piracy at all stages of its lifecycle, continuously promote and merchandise to game consumers, and seamlessly renew, update, and patch games after release—all while simplifying the underlying technology to deliver these services. Currently, we have a network of over 300 distribution partners and a catalog of over 1,600 games that it protects and promotes online.

### **Software Publishers**

Software and hardware manufacturers have access to a variety of tools with which to design and develop software. However, when such software needs to be delivered to customers, manufacturers have primarily relied on homemade solutions to handle electronic downloading, advanced installation, embedded licensing enforcement, automatic updates, and back-office tracking of entitlements. This not only places restrictions on the business models with which manufacturers can engage their customers, but also can lead to general business problems such as confusion as to which updates are needed and difficulty with installations.

Our FLEXnet Publisher product offers an extensive set of solutions for manufacturers and publishers. By incorporating our technologies into their products, manufacturers are able to improve their ability to provide a standard and seamless installation and activation experience, simplify product-marketing strategies, reduce unpaid usage and lower costs associated with product development, distribution, and delivery. We also offer manufacturers back-office products to help them better manage the entitlements they have granted their customers, as well as a hosted update service that enables manufacturers to keep their deployed products up to date and automatically deliver updates over the Internet.

### **Software as a Service**

Our Rights products, which include RightAccess and RightCommerce, also support content publishers moving from a shrinkwrap software model to a software as a service (“SaaS”) model. Our products allow media, publishing, entertainment and software companies to add subscription entitlement, access control, business intelligence and commerce functionality to their content and products. Our Rights products enable the sale and security of digital goods and services, such as text, audio, video, streaming media, games and applications. By using our Rights products, the customer’s end-user is able to access content over the internet, without the need for any installation, in order to have a seamless commerce experience. Additionally, our Rights products put control in the hands of business users, allowing sales and marketing professionals to test products, promotions and business models in real-time.

### **Enterprise End-Users**

Enterprise IT teams are looking for ways to keep their software end-users as productive as possible while minimizing their support costs. Organizations want to ensure they purchase enough licenses to fulfill the needs of their end-users but not waste money by continuing to license unnecessary assets. Such organizations also desire automated solutions that help them stay within the bounds of their purchased licenses, allow them to flexibly expand those bounds as needed, and maximize the reliability and availability of those licenses. Larger organizations also face significant challenges in rolling out software products to their thousands of employees and need to ensure that software is deployed easily without productivity loss to the enterprise.

Complementing our FLEXnet Publisher offerings for manufacturers, we offer the FLEXnet Manager offerings for enterprise customers, to help such customers better manage their FLEXnet enabled products. FLEXnet Manager captures and analyzes software usage data to help enterprises determine where to allocate their software purchases and related costs and helps administer software access rights (electronic licenses) over



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global networks. We also offer the AdminStudio family of products to help enterprise system administrators prepare various software applications and upgrades for deployment across the enterprise (via repackaging and patch impact management).

### **Technology Licensing, Sales and Marketing**

*Technology Licensing.* Content owners and software vendors utilize our solutions to secure their content or software and to ensure that their end-user customers pay them for the use of such content or software. We generate recurring revenues from a variety of sources by licensing our portfolio of digital content value management and software technologies. We receive royalties and recurring revenues as follows:

- Video and PC games content owners typically pay us a per-unit licensing fee for the right to use our proprietary content security solutions for DVDs, videocassettes and CD-ROM games and a service-based fee for the right to use our peer-to-peer file sharing content management technologies;
- Software vendors, enterprise end-user and Rights products customers pay us a fee to license our technology using either time-based licenses or perpetual licenses combined with annual maintenance fees;
- Content publishers pay us a fee to license our Rights product technology using perpetual licenses combined with annual maintenance fees, or for our hosted service, a subscription-based fee;
- Consumer software publishers pay us a per-unit licensing fee to use our technology for CD-ROM content security and time-based or perpetual licenses for our DRM technology;
- Digital set-top box and DVR manufacturers license our video content security solutions for an up-front fee and a per-unit royalty, a portion of which may be tied to product activation by system operators;
- Semiconductor companies that incorporate our digital PPV/VOD and DVD content security solutions into their semiconductor and reference designs pay us a one-time service fee to verify correct implementation of our content security technology in digital-to-analog application specific integrated circuits ("ASICs") that are embedded in digital set-top boxes and DVD hardware. They are authorized to sell these Macrovision-capable ASICs to Macrovision-licensed DVD hardware manufacturers and to Macrovision-licensed digital set-top box and DVR manufacturers;
- Cable and satellite television system operators pay us a one-time license fee for the right to incorporate our video content security technology into their networks for PPV or VOD services. In addition, we are entitled to transaction-based royalty payments when content security for digital PPV or VOD programming is activated by system operators and content protected programs are purchased by subscribers; and
- DVD hardware manufacturers (DVD consumer electronic player manufacturers and PC DVD drive suppliers) license our technology for an up-front fee and annual license fee.

*Sales and Marketing.* We market our digital content management and software management solutions directly to content owners and software vendors in the video, games and software markets. We also license our software asset management solutions directly to end-user enterprise customers. We supplement our direct sales efforts with reseller programs and service partnerships among VHS, DVD, and CD duplicator, replicator and authoring organizations, and third party professional services, value added reseller, and systems integrator organizations in our enterprise software business. We also utilize a variety of lead generating marketing initiatives, including trade show participation, trade advertisements, public relations, industry education and newsletters. As part of our FLEXnet platform, we established alliances with several companies to extend the FLEXnet ecosystem to include other third-party services and solutions. We have a worldwide network of resellers who help us sell our InstallShield products. The rapid expansion of broadband Internet connections for consumers and small businesses and the continued tightening of enterprise IT budgets may result in the adoption of new licensing and distribution models for our solutions. We believe this has created a large market opportunity for our products and solutions.

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### **Customers**

Our customers include major Hollywood studios; independent video producers; game producers and distributors, hardware and software vendors; information publishers; consumer electronic, PC and digital set-top box manufacturers; PPV and VOD network operators; online retailers and portal and enterprise IT organizations.

No customer accounted for more than 10% of our net revenues in 2006, 2005 or 2004.

### **Entertainment Producers and Distributors**

We believe that our DVD content security technology is utilized as the leading analog-to-analog and analog-to-digital content security solution that satisfies the principles established by the DVD licensing and standards group, and has been tested and accepted for compatibility with TV sets by leading consumer electronics companies. As of December 31, 2006, 423 companies that manufacture DVD players or Personal Computers with DVD-ROM drives had signed agreements with us to incorporate our DVD content security technology into their hardware. In addition, our entertainment content security solutions are licensed to 384 DVD authoring houses, 47 RipGuard mastering and/or replication providers, 38 RipGuard embedding service providers, 123 replication facilities, 228 VHS commercial duplication facilities, 153 digital set-top box and DVR manufacturers, 72 semiconductor component suppliers and 48 PPV/VOD system operators worldwide.

Our PPV/VOD content security technology is embedded in more than 249 million digital set-top boxes and digital media recorders currently in use worldwide. We have licensed our content security technology for digital PPV/VOD to 153 set-top box and DVR manufacturers and have licensed our analog content security solutions to Microsoft for home media center PC applications to protect PPV and VOD content.

Our content security technology customers include the following leading companies:

<u>Motion Picture Studios</u>	<u>PPV/VOD System Operators</u>	<u>Set Top Box / DVR Manufacturers</u>
<ul style="list-style-type: none"> <li>• Buena Vista Home Video (Disney)</li> <li>• HBO Home Video</li> <li>• New Line Cinema</li> <li>• Paramount Pictures</li> <li>• Twentieth Century Fox Home Entertainment</li> <li>• Universal Studios Home Video (NBC)</li> </ul>	<ul style="list-style-type: none"> <li>• British Sky Broadcasting (UK)</li> <li>• EchoStar Communications (USA)</li> <li>• FOXTEL Management (Australia)</li> <li>• Korea Digital Satellite Broadcast (Korea)</li> <li>• LodgeNet Entertainment (USA)</li> <li>• Netflix</li> <li>• NTL (UK)</li> <li>• Premiere Fernsehen (Germany)</li> <li>• SkyPerfecTV! (Japan)</li> </ul>	<ul style="list-style-type: none"> <li>• Fujitsu Limited</li> <li>• Hitachi Limited</li> <li>• Mitsubishi Electric</li> <li>• Panasonic (MEI)</li> <li>• Philips Business Electronics</li> <li>• Pioneer Electronics</li> <li>• Samsung Electronics</li> <li>• Scientific-Atlanta</li> <li>• Sony Electronics</li> <li>• THOMSON Multimedia</li> <li>• TiVo</li> <li>• Toshiba</li> </ul>

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Information Publishers	PC Games/Software Publishers	Trymedia
<ul style="list-style-type: none"> <li>• Channel 4 (UK)</li> <li>• FT.com</li> <li>• Hoovers</li> <li>• IDG</li> <li>• IEEE</li> <li>• New York Times</li> <li>• Standard &amp; Poors</li> <li>• Turner</li> </ul>	<ul style="list-style-type: none"> <li>• Activision</li> <li>• Eidos</li> <li>• Electronic Arts</li> <li>• Microsoft</li> <li>• 3DO</li> <li>• Ubisoft Entertainment</li> <li>• Vivendi Universal</li> </ul>	<ul style="list-style-type: none"> <li>• Atari</li> <li>• Disney</li> <li>• Take2 Interactive</li> <li>• Yahoo!</li> </ul>

## Software Publishers

We believe that FLEXnet Publisher, our core licensing technology supporting digital content management for software publishers, is a leader in the electronic license management market. We have licensed our FLEXnet-related technologies in a range of markets to more than 3,900 software and hardware manufacturers, including:

- |                          |                      |
|--------------------------|----------------------|
| • Adobe                  | • IBM                |
| • Autodesk               | • Sybase             |
| • Cadence Design Systems | • Synopsys           |
| • Cisco Systems          | • UGS PLM Solutions  |
| • Citrix                 | • Wind River Systems |

In addition, we believe that our InstallShield (for Windows) and InstallAnywhere (for multi-platform environments) are industry-leading installation authoring solutions, having been sold to over 71,000 customers. Ninety-eight of the top 100 software publishers use InstallShield.

## Enterprise End-Users

In addition we license our FLEXnet Manager to corporate/enterprise end-users, enabling these end-users to deploy, manage, and track the software they have purchased from our software vendor customers. Similarly, we have licensed our AdminStudio solutions to over 4,000 enterprise customers. Examples of such corporate end-user customers include:

- |                      |                    |
|----------------------|--------------------|
| • 3M                 | • IBM              |
| • BP                 | • Liberty Mutual   |
| • BMW                | • Lockheed Martin  |
| • Boeing             | • Motorola         |
| • Costco             | • Nokia            |
| • Eastman Kodak      | • Philips          |
| • Ford Motor Company | • Siemens          |
| • Honeywell          | • Sun Microsystems |
| • Hewlett Packard    |                    |

## The Macrovision Growth Strategy

*Build Upon Key Customer Relationships.* We currently maintain relationships with customers in various industry and market segments, including:

- Video and PC games' content providers such as the major Hollywood studios, independent movie producers and PC games publishers and distributors;
- Information Publishers, such as major media corporations, technical organizations and commerce generating companies that have expanded their printed properties into the digital marketplace;

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- Large online retailers and portal websites;
- Hardware and software vendors, as well as enterprise organizations that use their products;
- Content distributors such as the leading cable and satellite television system operators; and
- Consumer electronics manufacturers of DVD players, CD and DVD drives, PVRs, and digital set-top boxes.

We intend to build our business by capitalizing on these customer relationships and targeting them for delivery of our existing and future digital and distribution management technologies.

*Introduce New Product Applications and Technologies.* We intend to develop and acquire additional digital management solutions to sell to our extensive customer base. We have committed significant resources to expand our technology base, to enhance our existing products, to introduce additional products and to participate in industry standard-setting efforts and organizations. We intend to pursue opportunities to improve technologies in our current fields of operations as well as in the areas of future optical formats, internet downloaded files, P2P file sharing antipiracy and commerce enablement, DRM licensing and interoperability, software as a service, electronic license management and digital distribution solutions.

*Expand and Protect Patent Position.* We have built, and continue to add to, a large patent portfolio that helps differentiate our products. We believe that our future success will depend on our ability to continue to introduce proprietary solutions for rights management and content security solutions that can be supplemented by enabling features that will incent consumers and users to pay for legitimate video, audio and software products, rather than trying to get them for free in an unauthorized fashion. We have patented many of these proprietary solutions, and our patents underpin our strong competitive position and financial model. We also have acquired key software rights management and content security patents. We intend to continue to obtain patents and to protect and defend our patented technologies aggressively, including developing and obtaining patents covering a number of processes and devices that unauthorized parties could use to circumvent our DRM and content security solutions.

*Continue To Make Strategic Acquisitions.* We intend to continue to expand our technology portfolio and extend our businesses by pursuing licensing arrangements, joint ventures and strategic acquisitions of companies whose technologies or proprietary rights complement our technologies.

Between 1999 and 2003, we made a number of acquisitions of companies and technologies. Through these acquisitions, we acquired solutions for application software content security, electronic license management, software asset management and the DRM business. In August 2003, we acquired intellectual property and other assets from NetPD, including patents and software that can be used to track and manage content in the peer-to-peer file sharing space; in July 2004 and in June 2005, we acquired the intellectual property and assets of InstallShield Software Corporation and Zero G Software, Inc., respectively, both of which provided us with the ability to expand our product portfolio in the software management category and reach a larger software developer customer base. In July 2005, we acquired Trymedia Systems, Inc., which allowed us to move into the digital distribution and ecommerce enablement for the PC games market. In February 2006, we acquired eMeta Corporation, which extended our reach from physical distribution into the fast-growing online digital distribution segment and extended the breadth of our portfolio to include a broad spectrum of access control, usage entitlement, e-commerce and subscription management solutions. In January 2007, we acquired Mediabolic, Inc., which extended our capabilities in the delivery and enhancement of digital content through networking solutions to a wide variety of connected consumer electronics devices for the digital home. Mediabolic's entertainment networking software enables TVs, stereos, DVRs, PCs and other familiar consumer electronic devices to discover, store and play personal and internet-based content over the home network.

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### **Technology**

#### **Entertainment Producers and Distributors**

##### ***Video Technology***

Our technology was originally designed to prevent unauthorized copying of VHS cassettes. We extended our solution to inhibit unauthorized PPV/VOD copying and DVD-to-VHS copying. Hardware manufacturers have designed their DVD-R devices to recognize our content security signal to inhibit DVD-to-DVD copying as well. The majority of the recently introduced PVRs, DVD/VCR combo units include recording devices that are designed to sense widely used content security solutions, and, as a result, they recognize Macrovision's proprietary analog content security process and disable digital recording onto DVD discs.

***DVD and Digital PPV/VOD Content Security.*** Videocassettes and DVDs are encoded with our video content security signal as they are manufactured. The result is that videocassettes and DVDs that are encoded with our content security signal will play normally on an analog TV set, but will cause generally unwatchable copies to be made on most of VCRs, and will shut down the analog-to-digital recording circuit of DVD recording devices, which include DVD-R devices and personal computers. The DVD and digital PPV/VOD versions of our video content security solutions employ proprietary electronic pulses placed in analog video streams and a second patented content security process which affects the color playback circuit of a VCR causing colored horizontal stripes to appear in the picture of an unauthorized copy. The combination of the two processes provides a higher level of effectiveness than that provided by either process alone. In addition, the second patented content security process is more effective against circumvention by most "black box" circumvention devices that were sold in the past. Content protection is implemented in DVD and digital PPV/VOD applications by embedding a copy protection signal generator integrated circuit within the DVD player or digital set-top box. The content security circuits remain dormant until activated by data commands, which are either embedded in the DVD disc or sent along with the PPV movie transmission to the subscriber's set-top box or hard drive recorder. The integrated circuit is activated by copy protection control codes, which are embedded into the DVD media or the PPV transmission. Once the integrated circuit is activated, it adds the content security signal to the analog output of the DVD player or digital set-top box. As with videocassette content security, consumers are able to see a clear picture on their television sets, but generally cannot make a usable videocassette or DVD-R copy.

***ACP-VOD Content Management.*** Our ACP-VOD technology can be used by content owners to control how long their PPV/VOD content may be stored on compliant digital PVR units and home media center PC hard drives.

***RipGuard DVD.*** RipGuard DVD is the digital content security counterpart of our ACP technology. It is designed to inhibit software ripper programs that are used on consumer PCs to make unauthorized copies of DVDs. It can be used in conjunction with ACP to give a combination analog and digital content security solution for optical discs. RipGuard DVD is a unilateral content security solution, in that it is applied to the DVD disc at the time of manufacture, and is designed to have no impact on the quality of the displayed video and requires no hardware or special software on the PC or DVD player device.

***Peer-to-Peer File Sharing Solutions.*** Our Hawkeye technology can be used to protect content by deterring the unauthorized file sharing of all types of digital content, including video, music and games over numerous P2P networks.

##### ***PC Games Technology***

Our SafeDisc Advanced technology is licensed directly to software publishers, and to mastering and replication facilities that embed our patented digital signature during the CD manufacturing process. It is designed to prevent unauthorized copying by CD recorders or transfer from a CD/DVD-ROM to a hard disc drive, in a CD/DVD-ROM. SafeDisc is a "unilateral" content security solution, which means that all of the



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proprietary content security technology resides on the CD/DVD-ROM and nothing has to be added to or changed in the PC or CD/DVD-ROM hardware. Each CD/DVD-ROM published with the patented SafeDisc Advanced technology is premastered with encrypted executable files and contains authenticating instructions and a unique SafeDisc digital signature. Because SafeDisc Advanced is designed to operate while the disc is in the CD/DVD-ROM drive, it is ideally suited to PC games and education software and is not applicable for console games like Sony Playstation or Microsoft Xbox. When a user inserts an original SafeDisc-protected disc in a CD/DVD-ROM drive, the authentication software reads the digital signature, allowing the program to be decrypted and run normally. The digital signature and authentication process is transparent to the user. If a consumer or pirate uses a CD recording device or professional mastering equipment to duplicate a CD/DVD-ROM and make an unauthorized copy, SafeDisc is designed to inhibit the transfer of the digital signature to the copy. If someone attempts to use such an unauthorized copy, the digital signature cannot be found, decryption will not take place and the copy will not run.

SafeDisc also contains anti-hacking technology which is designed to prevent the compromise of its security features. Because of our widespread penetration in the PC games' market, hackers have targeted and cracked several versions of SafeDisc. For us to continue to be successful in this market, we must continually stay a step ahead of the hacker community.

Macrovision's ActiveMARK 2007 is a digital rights management solution that secures game content in a single binary for both physical and online distribution. ActiveMARK 2007's easy-to-use packaging tools allow publishers to apply rights management and security criteria, build a consistent brand across all channels, and leverage with-game advertising in trials. The ActiveMARK platform provides a flexible, turnkey solution for the digital distribution of game content online. ActiveMARK offers the capabilities required to get a branded game channel or storefront up and running quickly and easily, including comprehensive catalog, DRM, customer service and support, eCommerce, vast distribution network, merchandising, royalty reporting, in-content advertising and hosting.

## **Software Publishers**

FLEXnet Publisher enables software publishers and hardware manufacturers to price, package, and protect their software. Using FLEXnet Publisher, customers can electronically generate, track, enforce, and update their software licenses and guard against unauthorized use by implementing product activation or content security. FLEXnet Publisher also enables software publishers to generate additional revenue by offering their customers a broad choice of pricing and licensing models, including subscription- and usage-based models.

Software and hardware vendors integrate FLEXnet Publisher solutions into their products to monitor or control a customer's compliance with a product's license terms. Terms of the license are typically stored in an authenticated license file that resides either on the local computer's hard disk drive or on a network-connected central server. Compliance with those license rights is automatically monitored. The software vendor may choose to block users from running a product if doing so violates or exceeds the license rights, or simply provide notification to the user or system administrator when product use has exceeded the customer's license rights. This allows end user customers to buy software licenses using much more flexible license terms than traditional one-computer-one-license or site license approaches. These terms may include floating licenses (where a specific number of licenses are shared over a network), product suites (where several product licenses are combined to be licensed as a single product) and demo licenses (where a prospective customer has full functional use of a product, but the right to use expires on a specific date or after a specific number of uses). With FLEXnet Publisher, software vendors can enable users to "activate" previously unlicensed copies of the software over the Internet, or by typing in a series of digits provided. Electronic licensing can also record the use of licensed software into a transaction log, which is authenticated and encrypted so software vendors and customers can use this information as a basis for pay-per-use or other usage-based pricing or licensing.



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Software and hardware vendors apply our InstallShield technology to their finished products, in effect “wrapping” the application for installation. Software programs are then able to be installed and confirm to operating system standards. We cover non-Windows platforms with our InstallAnywhere product.

Our FLEXnet Connect technology is implemented as a program that resides on the end-user’s machine. It periodically checks the Internet for updates and downloads them as configured. End-users and/or their IT department system administration group can control how frequently (if at all) they want the service to check for updates, and what to do with those updates when available.

### **Software as a Service**

Macrovision’s Rights products give the customer the ability to derive more value out of their digital assets, whether they are a content publisher, software vendor, entertainment provider, or any other digital goods or services supplier. Our Rights products are made up of two core products: RightAccess for access control and RightCommerce for commerce, both of which can help the customer generate revenue and improve customer relationships by effectively controlling and commercializing digital goods and services.

RightAccess is an access control application that provides advanced authentication, authorization, product segmentation and delegated administration features for all types of digital goods and services, including Web-based software applications. RightAccess also enables registration and single sign-on. Additionally, it offers flexible licensing opportunities, whether end-users are consumers or institutional customers.

RightCommerce is a billing application that allows companies to implement a myriad of pricing models—including pay-per-view or -use, bundles and subscriptions—enabling them to generate revenue from digital assets. The assets can include text, audio, video, streaming media, games and applications. In addition, RightCommerce users can target their customers with free trials, discounts and gift certificates, while increasing incremental or add-on purchases with promotions and targeted pricing.

### **Enterprise End-Users**

Macrovision’s asset management software enables larger organizations to more effectively manage their licensed software, by providing interfaces to control licensed servers and set alerts to important licensing events. Moreover, this software can read and interpret the usage transaction logs described in the preceding section, enabling customers to better manage their FLEXnet enabled software assets and to allocate software-related costs to different departments or projects within the company through use of our FLEXnet Manager product. Our AdminStudio technology helps enterprise system administrators prepare various software applications and upgrades for deployment across the enterprise.

### **Research and Development**

Our internal research and development efforts are focused on developing enhancements to existing products, new applications for our current technologies and new technologies related to our various digital content value management offerings. Our core competencies are in electronic license management and license delivery software, installer software, anti-hacking software, digital and analog video and audio engineering, content security engineering and optical media formats. We have acquired other companies and technologies to supplement our research and development expenditures. In 2006, 2005 and 2004, our expenses for research and development were \$52.8 million, \$34.4 million and \$28.7 million, respectively.

Our primary locations for product development are in our Santa Clara (California), Schaumburg (Illinois), San Francisco (California), New York (New York), Alicante (Spain) and Maidenhead (United Kingdom) offices.

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### **Intellectual Property Rights**

*Patents Issued & Pending.* As of February 1, 2007, we hold 123 U.S. patents and have 134 U.S. patent applications pending. Of the issued patents, 45 relate to our content security solutions, 26 relate to video scrambling, 19 relate to audio scrambling, nine relate to electronic license management and five relate to DRM technology (namely content usage control, tracking, and e-transactions). Of the pending patent applications, 49 relate to our content security solutions, six relate to video scrambling, six relate to audio scrambling, 31 relate to electronic license management, 15 relate to DRM technology 16 relate to home networks and two relate to peer-to-peer networks. The last of our issued U.S. patents expires in 2024. The last of our core group of analog content security patents expires in the year 2020. We also have 868 foreign patents issued and 381 foreign patent applications pending in 43 countries. Of the issued foreign patents, 565 relate to our content security solutions, 104 relate to video scrambling, 33 relate to audio scrambling, and 49 relate to electronic license management and DRM.

*Circumvention Technology Patents.* Included in the patents related to our content security solutions are 14 U.S. and 117 foreign patents covering a number of processes and devices that unauthorized parties could use to circumvent our video content security solutions. We also have nine U.S. and 21 foreign circumvention technology patents pending. We have historically used these patents to limit the proliferation of devices intended to circumvent our video content security solutions.

### **Competition**

#### **Entertainment Producers and Distributors**

##### *Video Technology*

Our video content security solutions are proprietary and have broad U.S. and international patent coverage. We have the only analog content security solution that has been widely deployed on commercial products that significantly distorts or inhibits copying by VHS VCRs, DVD recorders and hard drive recorders. Currently, our video content security technology is embedded in nearly 100% of all DVD players and most digital set-top boxes worldwide. While it is possible that a competitive video content security technology could be developed and deployed, we believe it would take years for the competitive technology to be accepted by hardware manufacturers or embedded into the consumer electronic devices. By the time this would happen, it is unlikely any other analog content security technology would displace our content security infrastructure and our extensive video content security "ecosystem."

Our technology is designed to inhibit or prevent unauthorized consumer copying; it is not designed to prevent professional piracy. We believe that our customers are very concerned with professional piracy of their video, audio and software products. We believe that our customers' assessment of the relative threats of professional versus consumer piracy may present a certain level of competition to our video content security business, to the extent that some content owners may decide to devote more of their resources to fighting professional video piracy instead of using our content protection to deter unauthorized consumer copying.

With the increase in online content distribution over the Internet, and with the continuing advance of digital content and high definition formats, our analog video content security solutions that protect standard definition content on optical media and digital PPV/VOD signals may be viewed by our customers as being less important than the other digital and network content protection solutions. As a result, other Internet-based digital content security or DRM technologies may present significant competition to our video content security business, such as DRM offerings by Intertrust, Microsoft, Apple, RealNetworks, Contentguard, Philips, IBM and Sony. In addition, Sony's ARccOS product presents competition to our RipGuard DVD business. Competitors may also bundle their products with their own replication services, and by doing so, those competitors may be able to offer lower prices for the combined offering and therefore studios may switch to such replication facilities.

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*Peer-to-Peer File Sharing Content Management Technology.* We believe there are two primary competitors in the P2P file sharing content management segment: ARTISTdirect's MediaDefender and SafeNet's MediaSentry. While these competitors were the first in this segment and are very competitive in terms of pricing, we believe that our Hawkeye technology has the advantage of being able to more efficiently scale the solution to accommodate growing numbers of simultaneous titles/tracks that are content protected and has been proven to be more effective at deterring more downloads than the competition.

### ***PC Games Technology***

We believe that there are a limited number of competitors in our SafeDisc Advanced consumer software content protection segment, including Sony SecuROM (developed and marketed by Sony's DADC optical disk manufacturing subsidiary), StarForce Technologies, Settec and Smarte Solutions.

We also believe that there are a small number of competitors to ActiveMARK for the protection and digital distribution of games online, most notably Boonty, Oberon and Real Network's RealArcade.

### **Software Publishers**

Our primary competition in the electronic license management market comes from customers and prospects that develop their own homemade solutions. We have other more traditional competitors in various subcomponents of our offerings, including SafeNet (who acquired Rainbow Technologies, and has a license management offering) and Altiris (who acquired Wise and has an installer offering). There are other much smaller competitors as well, including companies such as XstreamLok, Softwrap and Reprise Software. Operating system developers such as Microsoft, IBM and Sun already integrate limited license management and installation functionality into their products, and they could expand this functionality, which could pose an increased competitive threat. Similarly, microprocessor suppliers may choose to integrate rights management solutions into their products, and software resellers could also begin to develop their own electronic license management solutions.

### **Software as a Service**

In both the content access control and digital commerce portion of our Rights products business, homegrown solutions may have a competitive impact (build vs. buy). In addition, other vendors such as CA/Netegrity, RSA Security (now part of EMC), Oracle, Novell and Citrix, may sell internal enterprise solutions to Information Publishers even though content access control is not core to their offering. As for additional competitors in the digital commerce space outside of homegrown who offer subscription management or content commerce platform, ThinkSubscription, Amdocs/Qpass, BitPass and others may appear in a competitive situation.

### **Enterprise End-Users**

Macrovision provides software asset management solutions to help end users monitor, manage, and track FLEXenabled and other software applications. Because we encrypt the FLEXnet usage log files, we are the only ones authorized to read and interpret the FLEXnet usage log files for purposes of software asset management. We believe that there are currently no significant competitors in this particular software asset management area. In the larger market of software asset management in general, products such as CA Unicenter, BMC Remedy and IBM Tivoli offer related and sometimes overlapping functionality.

AdminStudio enables enterprise system administrators to prepare various software applications and upgrades for deployment across the enterprise (via repackaging and patch impact management). It is used as a front-end preparation tool to assess whether there are any software application conflicts with other installed software prior to deploying to all the end user PCs. We believe our primary competitor is Altiris (for our AdminStudio and Windows installer business). Altiris acquired Wise's PackageStudio product.

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### **Operations and Technical Support**

We have technical support and certification operations to support our DVD manufacturer licensees, set-top box licensees, authorized semiconductor manufacturers, and our other hardware licensees. We provide technical support and professional services to our independent software vendor customers and enterprise end user organizations during pre-sale, installation, implementation and maintenance phases of our contracts.

We provide a variety of technical support to our customers, including:

- We support our licensed duplicators and replicators with hardware and software installation assistance and quality assurance. In addition, we support licensed duplicator/replicator sales personnel by providing sales training and marketing literature, and by participating in trade shows;
- We provide pre- and post-sales professional services and technical support, post-sales technical support, maintenance support, training, integration and software development services to customers incorporating FLEXnet and InstallShield in their applications, as well as to enterprises who use our FLEXnet Manager and Admin Studio solutions;
- We provide professional services for implementation and customization for both our RightAccess and Right Commerce solutions, including installation of access control, billing and payments infrastructure software.
- We support the efforts of television, VCR, PVR and DVD hardware manufacturers, digital PPV/VOD system operators and PPV/VOD set-top box manufacturers to design hardware that properly incorporates and is compatible with our video content security solutions;
- We assist semiconductor manufacturers in incorporating and certifying our video content security solutions into a variety of digital video integrated circuits;
- We regularly test the effectiveness and transparency of our video, audio and PC games content protection technologies on representative samples of consumer televisions, VCRs, DVD players, DVD drives, PVRs and recorder devices to determine whether modifications or enhancements may be necessary;
- We provide training and professional services to assist our independent software vendor licensees in wrapping their executables with our SafeDisc modules;
- We provide training and application support for the SafeDisc and RipGuard software toolkits; and
- We test for SafeDisc and RipGuard compatibility and effectiveness with a variety of PC and CD/DVD drive software and hardware.

Our strategy is to license our technologies to third parties that manufacture products or software incorporating our technologies. For our InstallShield products which are mostly distributed on CD-ROMs as boxed software, we contract with outside replicators to produce, package, and fulfill orders. Our manufacturing operations are limited to low volume video and audio content security processors used by third party replicators that require in-house system integration and quality control efforts.

### **Legislative and Regulatory Actions**

A number of government and legislative initiatives have been enacted in recent years to encourage development and implementation of technologies that protect the rights and intellectual property of the content owners.

In the United States, Congress enacted the Digital Millennium Copyright Act ("DMCA") in October 1998. This law required all VCRs to comply with analog copy protection technologies that are in widespread use, such

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as those covered in our patents, beginning in May 2000. The DMCA includes a clause that outlaws all circumvention devices and technologies that could be used to defeat widely used copy protection technologies. Based on our tests of new DVD recorder devices, we believe that manufacturers have designed them so they will not record analog input that is Macrovision copy-protected. Hence, our technology prevents copying on both VCRs and DVD-R devices. We also believe that software “ripper” products, when they include circumvention of copy protection or CSS encryption, are illegal under the law. In addition, we believe that software ripper companies who update their ripper products in order to circumvent RipGuard may be in violation of the anti-circumvention provisions of the DMCA. The U.S. law is based on a set of guidelines for amending basic copyright laws to deal with the protection of digital media. The guidelines were adopted in 1996 by the World Intellectual Property Organization, an agency of the United Nations.

Several countries in Europe have adopted a similar EU-wide copyright directive, which includes a provision aimed at controlling hardware and software circumvention devices and technologies. Individual countries’ legislatures are currently discussing these new copyright initiatives. The implementation of the Copyright Directive throughout Europe is continuing, with more countries enacting legislation. To date, Austria, Denmark, Germany, Greece, Italy and UK have implemented the Copyright Directive. The Directive brings into effect prohibitions on the manufacture, import, distribution, sale and marketing of circumvention devices and services. We have already taken action under the newly enacted German and UK Copyright Acts and obtained injunctions against a number of retailers to stop sales of devices that circumvent our technology.

In Japan, a revision to the Japanese copyright law went into effect in October 1999 prohibiting the sale, manufacture, and import of circumvention devices. In addition, an industry directive that became effective in 1997 requires all digital recording devices to be responsive to analog copy protection technologies that utilize automatic gain control techniques, such as those covered by our patents.

## **Strategic Investments**

We have made strategic investments in companies with complementary technologies and markets where we felt we could broaden our market reach or technology portfolio. The adjusted cost of our strategic investments as of December 31, 2006 was \$22.7 million and consisted of several investments, including an investment in Digimarc Corporation (“Digimarc”), a provider of patented digital watermarking technologies that allow digital code to be embedded in traditional and digital content, including movies, photographic images and documents such as financial instruments, passports and event tickets. In December 1997, we made our initial investment and signed a joint development agreement with Digimarc. We made two subsequent investments in June 1999 and October 2000, for a total of \$25.3 million. Digimarc completed an initial public offering in December 1999. As of December 31, 2006, we owned approximately 9.5% of Digimarc, which translated to a valuation of \$17.7 million. During 2005 and 2004, we determined that the decline in value of Digimarc stock was other-than-temporary and took a charge to earnings of \$5.8 million and \$5.3 million, respectively, as a result. There were no impairment charges relating to Digimarc in 2006.

In addition to the above investment, we made a \$5.0 million investment in a privately-held digital watermarking company for strategic purposes in 2006. We also have made and hold strategic investments in other companies that have been written down and have no recorded value as of December 31, 2006. During 2004, we recorded an other-than-temporary charge to earnings of \$180,000 related to our investment in iVast, a privately held company.

Our strategic investments represented 2.8% and 2.4% of our total assets as of December 31, 2006 and 2005, respectively. In total, we wrote off \$5.8 million and \$5.5 million for the years ended December 31, 2005 and 2004, respectively, related to impairments that were other-than-temporary. There were no other-than-temporary impairment charges in 2006. In the future, we may continue to evaluate and make such minority investments for strategic purposes.



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orders, a third party may be able to circumvent these security and business measures, and errors in the storage, use or transmission of personal information could result in a breach of customer privacy. A major breach of customer privacy or security by us or the third parties that hold and manage personal information could have serious negative consequences for our business, including the cost of a mandatory notification of data breach to customers, possible fines, penalties and damages, reduced customer demand for our services, harm to our reputation, regulation and oversight by federal or state agencies, and loss of our ability to accept and process customer credit card orders. We also have suffered losses, and may continue to suffer losses, as a result of Internet orders placed with fraudulent credit card or other payment data. The failure to detect or control payment fraud could have an adverse effect on our results of operations.

### **We may be subject to legal liability for the provision of third-party products, services or content.**

We periodically enter into arrangements to offer third-party products, services, content or advertising under our brands or via distribution on our websites or in our products or service offerings. We may be subject to claims concerning these products, services, content or advertising by virtue of our involvement in marketing, branding, broadcasting or providing access to them. Our agreements with these parties may not adequately protect us from these potential liabilities. It is also possible that, if any information provided directly by us contains errors or is otherwise negligently provided to users, third parties could make claims against us, including, for example, claims for intellectual property infringement. Investigating and defending any of these types of claims is expensive, even if the claims do not result in liability. If any of these claims results in liability, we could be required to pay damages or other penalties, which could harm our business and our operating results.

### **We may be subject to assessment of sales and other taxes for the sale of our products, license of technology or provision of services.**

We do not currently collect sales or other taxes on the sale of our products, license of technology or provision of services in states and countries other than those in which we have offices or employees. Our business would be harmed if one or more states or any foreign country were able to require us to collect sales or other taxes from past sales of products, licenses of technology or provision of services, particularly because we would be unable to go back to customers to collect sales taxes for past sales and would likely have to pay such taxes out of our own funds.

Effective July 1, 2003, we began collecting Value Added Tax, or VAT, on sales of “electronically supplied services” provided to European Union residents, including software products, games, data, publications, music, video and fee-based broadcasting services. There can be no assurance that the European Union will not make further modifications to the VAT collection scheme, the effects of which could require significant enhancements to our systems and increase the cost of selling our products and services into the European Union. The collection and remittance of VAT subjects us to additional currency fluctuation risks.

The Internet Tax Freedom Act, or ITFA, which Congress extended until November 2007, among other things, imposed a moratorium on discriminatory taxes on electronic commerce. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

### **We license technology for digital VOD and PPV copy protection, and if this market does not grow as anticipated or we are unable to serve this market effectively, our revenues may be adversely affected.**

While our copy protection capability is embedded in more than 197 million digital set-top boxes manufactured by the leading digital set-top box manufacturers, only approximately 5 cable or satellite system operators in North America have activated copy protection for digital PPV or VOD programming. Our ability to expand our markets in additional home entertainment venues such as digital PPV or VOD will depend in large part on the support of the major motion picture studios in advocating the incorporation and activation of copy



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protection technology in the hardware and network infrastructure required to distribute such video programming. If the MPAA studios do not require copy protection activation for PPV or VOD movies, or if PPV/VOD system operators do not specify our copy protection in their set-top boxes, or if the system operators do not activate copy protection in other digital PPV networks outside of Canada, Germany, Japan, Hong Kong or the United Kingdom, then our business may be harmed.

Further, consumers may react negatively to copy protected PPV or VOD programming because they may feel they are entitled to copy, having in the past routinely copied for later viewing analog cable and satellite-delivered subscription television and PPV programs, as well as free broadcast programming. In addition, when incoming video signals are routed through a VCR before reaching a TV set, the consumer may see impaired pictures while viewing a copy protected digital PPV program. If there is consumer dissatisfaction that cannot be managed, or if there are technical compatibility problems, our business could be harmed.

### **Pricing pressures on the content owners that incorporate our technologies into their products could limit the licensing fees we charge for our technologies, which could adversely affect our revenues.**

The markets for the products in which our technologies are incorporated are intensely competitive and price sensitive. Retail prices for such products that include our technology, such as DVDs and CDs, have decreased significantly, and we expect prices to continue to decrease for the foreseeable future. In response, content owners have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge our customers who incorporate our technologies into the products they sell. A decline in the licensing fees we charge could materially and adversely affect our operating results.

### **If we are unable to compete effectively with existing or new competitors, we could experience price reductions, fewer customers, reduced margins or loss of market share.**

We believe that our DVD digital-to-analog copy protection and videocassette copy protection systems currently have no competitors. It is possible, however, that competitive copy protection technologies could be developed in the future. Increased competition would be likely to result in price reductions and loss of market share, either of which could harm our business.

In the video market segment, there are a variety of supplemental copy protection and encryption systems that provide partial copy protection for digital links (the DTLA 5C encryption technology); the 4C pre-recorded media and recordable media copy protection systems; CSS, a content scrambling system for the DVD format; Intel's High Definition Copy Protection ("HDCP") encryption for both the Digital Display Working Group's Digital Video Interfaces ("DVI") and HDMI Licensing, LLC's High Definition Multimedia Interface ("HDMI"). These systems are not directly competitive, as some apply to future products, but they are sometimes confused with our analog copy protection and may create uncertainty in the minds of customers, thereby reducing or delaying our licensing opportunities. Additionally, they may compete from the standpoint of content owners believing they have a limited budget for copy protection, and they may choose to spend their copy protection dollars on only a few technologies.

Our primary competition in the electronic license management market segment currently comes from our own prospective customers—those independent software vendors who believe they can develop their own electronic license management solutions instead of purchasing them. In the event that software vendors succeed with their internal developments, or forego the implementation of such applications, this would adversely affect our business. Other competitors include companies offering digital rights management, electronic licensing, or electronic software distribution technology, as well as companies that have historically offered hardware dongle products and are shifting to software-based protection. Operating system developers or microprocessor suppliers may choose to integrate rights management solutions into their products. Software resellers could also begin to develop their own electronic license management solutions. In addition to having more traditional competitors in

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various subcomponents of our offerings, such as SafeNet that has a license management offering and Altiris that has an installer offering, we may face new or increased competition from smaller and emerging companies such as XstreamLok, Softwrap and Reprise Software.

Our other software solutions, namely our InstallShield Installer, Update Service, InstallAnywhere and Admin Studio experience competition from other products. In the installer business, Altiris' Package Studio is the primary competition for our Admin Studio solution and Microsoft may be a competitor in the future. Update Service appears to have no competition other than from our customers.

There are a limited number of competitors in our SafeDisc Advanced consumer software copy protection market segment, including SecureRom, Sony's DADC optical disk manufacturing subsidiary, and StarForce Technologies. However, it is possible that our own customers may develop software copy protection technologies, or that personal computer operating system and microprocessor companies may develop or license copy protection modules or systems that are internal to the PC or other consumer electronic devices.

In the consumer software product activation market segment, as in the enterprise software electronic license management market segment there is substantial competition from customer implemented internally developed solutions, as well as from small companies such as Australian company XstreamLok, and software e-commerce vendors like Digital River.

DRM solutions for consumer software, video, and audio have also attracted a number of companies and significant venture capital, including Intertrust Technologies (owned by Sony and Philips), Microsoft, Content Guard, Apple, and Real Networks. It is possible that companies with extensive financial resources may develop or acquire copy protection and rights management solutions that compete with our offerings, or may have a controlling patent position which would negatively impact our cost basis, or may give away their DRM technologies as in the case of the Windows Media Player.

In the connected device middleware market segment, there is competition from customer-implemented internally-developed solutions, as well as from companies such as DigiOn, BridgeCo, Syabas, Moxi and Oregon Networks.

New competitors or alliances among competitors may emerge and rapidly acquire significant market share in any of these areas. Our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements than we do, which could reduce demand for our products or render them obsolete.

**It may be more difficult for us, in the future, to have our technologies adopted as individual industry standards to the extent that entertainment industry participants collaborate on the development of industry standard technologies.**

Increasingly, standards-setting organizations are adopting or establishing technology standards for use in a wide-range of consumer electronics products. As a result, it is more difficult for individual companies to have their technologies adopted wholesale as an informal industry standard. In addition, increasingly there are a large number of companies, including ones that typically compete against one another, involved in the development of new technologies for use in consumer entertainment products. As a result, these companies often license their collective intellectual property rights as a group, making it more difficult for any single company to have its technologies adopted widely as a de facto industry standard or to have its technologies adopted as an exclusive, explicit industry standard. Examples of this include MPEG-LA (DRM licensing); Advanced Access Control System (AACS) for next generation DVD encryption; HD-DVD and BluRay DVD (next generation DVD formats). If our technologies are not supported by these standards bodies or patent pools, it may be more difficult for us to grow our business in the future. Our major customers may have a large influence on industry standards and the widespread adoption of new technologies. The selection of alternative technologies to ours or to those on which our technologies operate would harm our business.